

## Message Text

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PAGE 01 THE HA 03472 01 OF 03 080529Z  
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LIMITED USE SECTION 1 OF 3 THE HAGUE 3472

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SUBJECT: POST-ELECTION ECONOMIC PROSPECTS

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1. SUMMARY: DETERIORATION IN THE DUTCH ECONOMIC SITUATION AND PROSPECTS IS FORCING ECONOMIC POLICY-MAKERS TO FACE THE DIFFICULT TASK OF FINDING PRACTICAL SOLUTIONS TO BOTH IMMEDIATE SHORTCOMINGS AND LONG-TERM WEAKNESSES. WITH THE POLITICAL RESTRAINTS OF A CAMPAIGN OUT OF THE WAY, POLICY-MAKERS ARE BEGINNING TO SPEAK IN LESS POPULAR BUT MORE PRACTICAL TERMS ABOUT HOW TO DEAL WITH INCREASING UNEMPLOYMENT, RISING INFLATION, LOW PRIVATE INVESTMENT AND A LOWER RATE OF GROWTH. END SUMMARY.

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PAGE 02 THE HA 03472 01 OF 03 080529Z

2. INTRODUCTION: THE IMPROVEMENTS IN THE DUTCH ECONOMIC PERFORMANCE NOTED DURING THE CAMPAIGN PERIOD HAVE BEGUN TO EVAPORATE. INDUSTRIAL PRODUCTION HAS STAGNATED. UNEMPLOYMENT HAS BEGUN TO MOVE UP AGAIN. EXPECTED INCREASES IN INVESTMENT IN 1977 ARE FORECAST TO STALL OUT NEXT YEAR. INFLATION FORECASTS, WHICH

HAD BEEN REDUCED IN THE EARLY PART OF THE YEAR, ARE BEING QUESTIONED. THERE IS A GROWING RECOGNITION THAT MEDIUM-TERM PROBLEMS ARE EVEN MORE SEVERE THAN ORIGINALLY THOUGHT AND THAT THE GOVERNMENT'S RESPONSE SO FAR IS INADEQUATE. AS POLICY MAKERS REFOCUS THEIR VISION FROM THE VERY SHORT TERM OF THE PRE-ELECTION PERIOD TO FARTHER HORIZONS, THEY ARE REALIZING THAT THE ECONOMIC PICTURE IS DARKER THAN THEY HAD THOUGHT AND THAT THE REMEDIES WILL BE GENERALLY LESS PALATABLE THAN HAD BEEN HOPED. FINDING THE POLITICAL WILL TO IMPLEMENT THE NECESSARY MEASURES AND TO MEET SOCIAL POLICY OBJECTIVES WILL KEEP THE NEXT CABINET UNDER A CONSTANT STRAIN.

3. POLITICAL FRAMEWORK OF ECONOMIC SITUATION--THE GLOOMY PROSPECT OF 300,000 UNEMPLOYED HAS BROUGHT FORTH A REALIZATION THAT CLEAR AND DECISIVE POLICY MEASURES ARE NEEDED TO RESTORE ECONOMIC HEALTH. RECOMMENDATIONS VARY CONSIDERABLY AND ARE BEING CONSTANTLY ADJUSTED IN THE FRAMEWORK OF THE CABINET FORMATION BUT THE COMMON THEME EMERGING IS THAT INVESTMENT IS THE KEY TO DUTCH ECONOMIC RECOVERY.

A. THE CENTRAL PLANNING BUREAU (CGG) HAS, CONTRARY TO ITS CUSTOM, PUBLICLY MADE SOME DIRECT POLICY RECOMMENDATIONS. THE CPB CALLS FOR A "GIGANTIC ECONOMY LIMITED OFFICIAL USE

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PAGE 03 THE HA 03472 01 OF 03 080529Z

OPERATION" TO HALT THE GROWTH OF THE PUBLIC SECTOR AS A SHARE OF NATIONAL INCOME. IN ALL THE CPB WOULD LIKE TO SEE 13 BILLION GUILDERS IN CUTS IN PLANNED EXPENDITURE BETWEEN NOW AND 1980. THIS IS IN ADDITION TO THE 8 BILLION REDUCTION OF GROWTH WHICH WILL OCCUR UNDER THE GOVERNMENT'S "ONE PERCENT POLICY." (SEE REFS) REDUCED PUBLIC SECTOR GROWTH WILL BE NEEDED TO RESTORE PROFITABILITY TO TRADE AND INDUSTRY, WHICH WILL STIMULATE JOB-CREATING INVESTMENT. A REDUCTION IN THE LABOR SHARE OF INCOME (AND THE CONSEQUENT INCREASE IN PROFITS) BY ONE PERCENTAGE POINT PER YEAR WOULD, ACCORDING TO THE CPB, CREATE 50,000 TO 100,000 NEW JOBS. CPB CALLS FOR A TWO PERCENTAGE POINT A YEAR CUT.

B. THE PRESTIGIOUS TRIPARTITE SOCIAL ECONOMIC COUNCIL (SER) ISSUED A REPORT PREPARED BY AN ECONOMIC SUB-COMMITTEE COMPOSED OF ECONOMISTS FROM ALL THREE MAJOR POLITICAL PARTIES CALLING FOR A SIMILAR EFFORT TO IMPROVE PROFITS ( REF B) AND TO RESTORE INVESTMENT.

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PAGE 01 THE HA 03472 02 OF 03 080537Z  
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LIMITED OFFICIAL USE SECTION 2 OF 3 THE HAGUE 3472

C. THE EMPLOYERS FEDERATION(VNO) HAS RESTATED ITS  
OPPOSITION TO THE PROFIT SHARING AND STRENGTHENED  
WORKS COUNCILS (SEE F BELOW), SAYING THESE MEASURES  
WILL DISCOURAGE INVESTMENT AND FURTHER REDUCE JOB  
CREATION. VNO HAS CONTINUED TO STRESS INCREASED PROFITS  
AND REDUCED GROWTH IN WAGES AS THE KEY TO STIMULATING  
NEW JOB CREATING INVESTMENT.

D. TRADE UNIONS HAVE ATTACKED THE LINKAGE OF PROFITS,  
INVESTMENTS AND JOBS AS UNFOUNDED. THEY CRITICIZE EFFORTS  
TO IMPROVE PROFITS AS OFFERING NO GUARANTEE OF IMPROVED  
EMPLOYMENT. THEY HAVE CALLED FOR "SPECIFIC" MEASURES  
AIMED DIRECTLY AT CREATING NEW JOBS AS OPPOSED TO GENERAL  
MEASURES OFFERING ONLY AN INDIRECT EFFECT ON EMPLOYMENT.  
UNIONS HAVE, HOWEVER, MADE SOME CONCESSIONS AND NOW AGREE  
THAT THERE IS LITTLE ROOM AVAILABLE FOR REAL WAGE  
INCREASES OR EXPANSION OF SOCIAL PROGRAMS. THEY ARE CON-  
CENTRATING THEIR EFFORTS ON GAINING THE PACKAGE OF SOCIAL-  
ECONOMIC REFORM WHICH FAILED IN THE LAST PARLIAMENT.  
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PAGE 02 THE HA 03472 02 OF 03 080537Z

E. PRIME MINISTER (AND CABINET "FORMATEUR") DEN UYL

JULY 5 CALLED FOR A FREEZE IN REAL WAGES FOR THE NEXT TWO YEARS AND FOR FURTHER RESTRAINTS IN GOVERNMENT EXPENDITURE. THE DEN UYL PROPOSAL, PUT FORWARD AS A BASIS FOR NEGOTIATION ON ECONOMIC POLICY IN THE CABINET FORMATION PROCESS, WOULD ALLOW MAINTENANCE OF THE PURCHASING POWER OF WORKERS AT THE LOWER AND MIDDLE LEVELS, BUT WOULD FREEZE HIGHER INCOMES COMPLETELY. DEN UYL CLAIMS THAT THESE MEASURES WILL GIVE TRADE AND INDUSTRY THE BREATHING SPACE NEEDED TO RESTORE ECONOMIC ACTIVITY. OTHER POLITICAL LEADERS HAVE YET TO RESPOND TO DEN UYL'S PROPOSALS.

F. LEADERS OF THE MAJOR POLITICAL PARTIES HAVE BEEN FOCUSSED MOST OF THEIR EFFORTS ON THE DIFFICULT NEGOTIATIONS ON THE FORMATION OF A NEW CABINET. AMONG THE KEY FACTORS IN THESE NEGOTIATIONS WILL BE THE FATE OF THE "REFORM" BILLS, WHICH HAVE CREATED SOME UNCERTAINTY IN THE BUSINESS ENVIRONMENT AND HAVE BEEN THE CORNERSTONES OF THE PAST DEN UYL GOVERNMENT'S POLICIES. COMPULSORY PROFIT SHARING (VAD, 76 THE HAGUE 2501) AND STRENGTHENED WORKS COUNCILS HAVE BEEN THE MOST WORRISOME OF THE REFORMS FOR BUSINESS. THE LAND REFORM BILL ON WHICH THE PREVIOUS CABINET FELL, WHILE OF IMPORTANCE TO INDIVIDUAL PROPERTY OWNERS, IS OF ONLY INDIRECT INTEREST TO MOST BUSINESSES, AND THE SELECTIVE INVESTMENT LAW (SIR, THE HAGUE 1067) HAS PROVEN TO BE MORE ACCEPTABLE TO FIRMS THAN HAD BEEN EXPECTED. AT THIS STAGE, SPECIFIC ECONOMIC POLICIES ARE JUST BEGINNING TO EMERGE AND THESE WILL BE SUBJECT TO MODIFICATION IN NEGOTIATIONS IN THE CABINET FORMATION PROCESS. HOWEVER, THERE ARE INDICATIONS THAT THE NEW GOVERNMENT WILL BE INCLINED TO LIMITED OFFICIAL USE

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PAGE 03 THE HA 03472 02 OF 03 080537Z

TO FOLLOW THE RECOMMENDATIONS OF THE CPB AS FAR AS IS POLITICALLY FEASIBLE.

4. ECONOMIC BACKGROUND: CURRENT SITUATION AND SHORT-TERM OUTLOOK--THE POLICY DEBATES DISCUSSED ABOVE SHOULD BE VIEWED AGAINST THE BACKDROP OF A RAPIDLY CHANGING ECONOMIC SITUATION, THE KEY ELEMENTS OF WHICH ARE SUMMARIZED IN THE FOLLOWING PARAGRAPHS.

A. UNEMPLOYMENT--THE DECLINE IN UNEMPLOYMENT NOTED IN THE LATTER PART OF 1976 AND IN EARLY 1977 HAS ENDED AND FIGURES HAVE NOW BEEN CREEPING UPWARDS AGAIN FOR THE PAST FOUR MONTHS. ALTHOUGH FORECASTERS HAD EXPECTED UNEMPLOYMENT TO STOP DECLINING OR EVEN INCREASE AGAIN LATER IN 1977, THE EARLY ONSET CAME AS A SURPRISE AND AN INDICATOR THAT STRUCTURAL WEAKNESSES MAY BE MORE SEVERE THAN THOUGHT. UNEMPLOYMENT IS NOW EXPECTED TO INCREASE

SLOWLY BUT STEADILY FOR THE REMAINDER OF THE YEAR,  
PERHAPS LEVELING OFF AT THE END OF THE YEAR. THE  
AVERAGE LEVEL FOR THE YEAR SHOULD REMAIN NEAR THE 1976  
LEVEL OF 224,000 RATHER THAN DECLINING TO 210,000 AS  
PREVIOUSLY EXPECTED.

B. PRICES--THE DAMPENING EFFECT OF THE GUILDR'S  
STRENGTH ON PRICES APPEARED TO HAVE WORKED ITSELF OUT  
BY THE FIRST QUARTER OF 1977 AND PRIVE INCREASES BEGAN

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PAGE 01 THE HA 03472 03 OF 03 080553Z  
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LIMITED OFFICIAL USE SECTION 3 OF 3 THE HAGUE 3472

TO ACCELERATE IN APRIL. THE CPB IS NOW BEGINNING TO  
RETRACT ITS FORECASTS OF REDUCED INFLATION (6.5 PERCENT) IN  
1977 WHICH WERE ISSUED IN THE FIRST QUARTER AND TO  
RETURN TO EARLIER PREDICTIONS OF AROUND 7.5 PERCENT. SOME  
ACADEMIC ANALYSTS RECENTLY HAVE ACCUSED THE CPB OF  
SERIOUSLY UNDERFORECASTING INFLATION AS A RESULT OF A  
"MONEY DOESN'T MATTER" PHILOLOPHY UNDERLYING ITS ECONO-  
METRIC MODEL. CRITICS HAVE SET INFLATION AT 8.5 PERCENT OR  
MORE, BASED IN PART ON LAST YEAR'S 23 PERCENT GROWTH IN THE  
MONEY SUPPLY (M2). THE NETHERLANDS BANK HAS MADE AN  
EFFORT TO DAMPEN MONEY SUPPLY GROWTH, BUT WITH ONLY  
LIMITED SUCCESS, SINCE ITS ACTIONS HAVE BEEN QUICKLY  
OFFSET BY FOREIGN FUNDS FLOWING IN AS A RESULT OF THE  
STRONG GUILDER.

C. INDUSTRIAL PRODUCTION--ORIGINAL PROJECTIONS OF  
4.5 PERCENT GROWTH OF INDUSTRIAL PRODUCTION HAVE BEEN REDUCED  
TO 3.5 PERCENT FOR 1977. EVEN THE LATTER FIGURE MAY NOW BE  
EXCESSIVE. INDUSTRIAL PRODUCTION HAS BEEN VIRTUALLY  
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PAGE 02 THE HA 03472 03 OF 03 080553Z

UNCHANGED SINCE OCTOBER 1976. IMPROVEMENTS IN CERTAIN  
INDUSTRIES, SUCH AS CHEMICALS AND FOOD AND BEVERAGE  
PROCESSING AND BUILDING MATERIALS HAVE KEPT THE INDEX  
FROM SHOWING A DISTINCT DECLINE. THE SHARE OF THESE  
INDUSTRIES IN EMPLOYMENT IS SMALL. IN PROJECTING  
INDUSTRIAL PRODUCTION IN 1977 THE CPB RELIED HEAVILY  
ON INCREASES IN EXPORT ORDERS AND INVESTMENT TO STIMU-  
LATE PRODUCTION. EXPORTS HAVE FALLEN SHORT OF  
EXPECTATIONS. INVESTMENT PROJECTIONS HAVE BEEN EXTREMELY  
VOLATILE, STARTING AT 8 PERCENT IN THE ORIGINAL FORECAST DONE  
IN SEPTEMBER 1976 DECLINING TO 7 PERCENT AT THE TIME OF THE  
JANUARY OECD REVIEW AND RECHING 14 PERCENT IN THE IMMEDIATE  
PRE-ELECTION PERIOD, BASED ON THE EXPECTED EFFECTS OF THE  
SELECTIVE INVESTMENT ACT, WHICH FAILED TO CLEAR PARLIA-  
MENT BEFORE ELECTIONS. CPB EXPECTS INVESTMENT TO INCREASE  
BY NO MORE THAN ONE PERCENT IN 1978.

D. ECONOMIC GROWTH--LACK OF TIMELY GNP FIGURES MAKES  
IT DIFFICULT TO ASSESS CURRENT GROWTH AND GROWTH PROS-  
PECTS. THE BEST AVAILABLE APPROXIMATION HAS BEEN  
INDUSTRIAL PRODUCTION(DISCUSSED ABOVE), BUT THIS  
EXCLUDES THE SERVICES SECTOR, A SIGNIFICANT AND GROWING  
SECTOR OF THE DUTCH ECONOMY AND ONE WHICH IS MUCH  
HEALTHIER THAN THE INDUSTRIAL. THIS SECTOR SHOULD PULL  
OVERALL GROWTH SLIGHTLY ABOVE THE INDUSTRIAL PRODUCTION  
FIGURE. THREE TO 3.5 PERCENT WOULD REPRESENT A SAFE PRO-  
JECTION, COMPARED TO THE 3.5 PERCENT FORECAST IN FEBRUARY AND  
THE 4.5 PERCENT  
PROJECTED IN APRIL.

5. MEDIUM-TERM OUTLOOK-- ON THE BASIS OF THE LATEST CPB  
FORECAST, THE MEDIUM-TERM OUTLOOK FOR THE DUTCH ECONOMY  
HAS DETERIORATED SHARPLY. PRIMARY REASONS GIVEN FOR THE  
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PAGE 03 THE HA 03472 03 OF 03 080553Z

DETERIORATION ARE MORE RAPID GROWTH OF THE LABOR SUPPLY  
THAN EXPECTED, THE STRENGTH OF THE GUILDER AND THE  
WEAKER-THAN-XPECTED RECOVERY FROM THE RECESSION.  
UNEMPLOYMENT, WHICH HAD BEEN FORECAST TO BE 150,000 IN  
1980, IS NOW EXPECTED TO REACH 300,000 WITHOUT DRASTIC

POLICY ACTION. GROWTH IN GNPS, WHICH HAD BEEN EXPECTED TO AVERAGE 3.75 TO 4 PERCENT PER YEAR, IS NOW FORECAST TO AVERAGE 3.5 PERCENT. THE NEW UNEMPLOYMENT PROJECTION IS A RESULT OF THE LOWER GROWTH RATE AND THE EXPECTATION OF A LARGER NUMBER OF MARRIED WOMEN ENTERING THE LABOR FORCE. THE STRONG GUILDER'S DELETERIOUS EFFECT ON DUTCH EXPORT PROSPECTS IS A MAJOR FACTOR IN THE REDUCED GNP GROWTH.

6. CONCLUSION: THESE ECONOMIC PROBLEMS WHICH WILL CONFRONT THE NEW GOVERNMENT HAVE NOT BEEN UNFORESEEN. THE CPB BEGAN TO WARN IN 1975 THAT THE COSTS OF DUTCH SOCIAL PROGRAMS AND REFORMS WERE BECOMING TOO HEAVY A BURDEN FOR THE ECONOMY. THE CABINET NOW BEING FORMED FACES AN EVEN MORE DIFFICULT TASK BECAUSE OF THE INABILITY OF THE PREVIOUS CABINET TO TAKE THE NECESSARY MEASURES, WHICH HAVE BECOME EVEN MORE URGENT.  
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